

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 OES-03 FEA-01 INT-05 SP-02 AID-05 EB-04

NSC-05 RSC-01 CIEP-01 TRSE-00 SS-15 STR-01 OMB-01

CEA-01 CIAE-00 COME-00 FRB-01 INR-05 NSAE-00 XMB-02

OPIC-03 LAB-01 SIL-01 L-02 H-01 PA-01 PRS-01 USIA-06

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R 211400Z OCT 74

FM AMEMBASSY MONTEVIDEO

TO SECSTATE WASHDC 7531

INFO AMEMBASSY BUENOS AIRES

C O N F I D E N T I A L MONTEVIDEO 3007

JOINT STATE/AID

E.O. 11652: GDS

TAGS: ECON, EFIN, UY

SUBJ: RESULTS OF GOU CONSULTATIONS WITH IMF-IBRD AND OTHER  
EXTERNAL ASSISTANCE SOURCES

1. IN CONVERSATION WITH AID REPRESENTATIVE, CARLOS KONCKE,  
SENIOR CENTRAL BANK ECONOMIST WHO PARTICIPATED IN WASHINGTON  
CONSULTATIONS WITH IMF AND IBRD, REPORTED FOLLOWING RESULTS:

A. GENERAL AGREEMENT WAS REACHED WITH IMF ON GUIDING  
PRINCIPLES AND CONDITIONS OF STANDBY AND WITH IBRD ON CONDITIONS  
FOR RELATED PROGRAM ASSISTANCE. THE GOU WILL NOW PREPARE A  
DETAILED ECONOMIC PROGRAM WHICH WILL BE NEGOTIATED WITH A JOINT  
IMF-IBRD TEAM SCHEDULED TO VISIT MONTEVIDEO STARTING DECEMBER.

2. IN ADDITION, THE IBRD AGREED TO GOU REQUEST FOR A RESI-  
DENT BANK MISSION IN URUGUAY.

B. THE IMF STANDBY, BEGINNING WITH THE SECOND CREDIT TRANCHE,  
WOULD EXTEND FOR ONE YEAR, PROVIDE \$20 MILLION (SDR 17.5 MILLION)  
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AND WOULD CONTAIN QUALITATIVE PERFORMANCE CRITERIA.

C. A RELATED IBRD PROGRAM LOAN AMOUNTING TO BETWEEN \$50-100 MILLION WOULD BE RECOMMENDED BY THE STAFF, WOULD BE GEARED TO PROGRESS ON SPECIFIC REFORM MEASURES WITH QUANTITATIVE PERFORMANCE CRITERIA AND WOULD LIKELY BE USED DURING 1975 TO COVER EXPECTED BALANCE OF PAYMENTS DEFICITS, AND FINANCE ESSENTIAL IMPORTS. IN ADDITION, THE IBRD WILL CONTINUE WORK ON THE 5TH LIVESTOCK LOAN (PLAN AGROPECUARIO) AND WOULD BE PREPARED TO CONSIDER ASSISTANCE ON THE ENERGY PROGRAM (PALMAR DAM).

D. THE IMF WILL PROVIDE SDR 29 MILLION FROM ITS OIL FACILITY IN ADDITION TO SDR 17.5 MILLION ALREADY COMMITTED IN SEPTEMBER FOR A TOTAL OF SDR 46.5 MILLION OR \$50 MILLION TO PARTIALLY COVER THE 1974 BALANCE OF PAYMENTS DEFICIT WHICH KONCKE NOW ESTIMATES AT BETWEEN \$130-140 MILLION OR POSSIBLY MORE.

2. KNOCKE ALSO CONFIRMED PREVIOUS REPORTS THAT GOU PLANS TO USE ONE MILLION OUNCES OF GOLD(NOW PLEDGED IN EUROPE) TO REPLEDGE AT CURRENT PRICES TO PROVIDE \$90 MILLION OF NET NEW FINANCING (AFTER PAYING OFF \$30 MILLION DUE ON THE OLD LOAN). NEGOTIATIONS ARE UNDERWAY WITH A BANKING SYNDICATE TO ARRANGE THE OPERATION, THE PROCEEDS OF WHICH WILL ALSO BE USED TO COVER THE 1974 BALANCE OF PAYMENTS DEFICIT. KONCKE ADVISES THAT THIS OPERATION WILL PROBABLY HAVE TO AWAIT THE DISBURSEMENT OF ALL THE OIL FACILITY FUNDS SO AS NOT TO ADD TO GROSS RESERVES, WHICH UNDER IMF RULES, WOULD TRIGGER AN AUTOMATIC REPURCHASE REQUIREMENT BY APRIL 1975. SUCH A REPURCHASE WOULD LIKELY MEAN REPAYMENT OF THE IMF IN GOLD, GIVEN THE HEAVY PERCENTAGE OF GOLD IN THE GOU'S TOTAL RESERVES. KONCKE PRIVATELY BEMOANED THE RELUCTANCE OF THE MILITARY AND CENTRAL BANK BUREAUCRACY TO SELL GOLD, A FACTOR WHICH LIMITS THE USEFULNESS OF IMF ASSISTANCE.

3. AS PREVIOUSLY REPORTED, THE GOU PLANS TO ISSUE NEXT MONTH UP TO \$300 MILLION IN TREASURY BONDS IN THE FOLLOWING SERIES:

- A. 12 1/2 PERCENT FIXED INTEREST WITH 10 YEAR MATURITY.
- B. 2 PERCENT ABOVE EURODOLLAR INTERBANK RATE WITH 5 YEAR MATURITY.
- C. 2 3/4 PERCENT ABOVE EURODOLLAR INTERBANK RATE WITH 10 YEAR MATURITY.

THE FIRST NATIONAL CITY BANK OF NEW YORK IS REPORTEDLY TRYING TO ORGANIZE A SYNDICATE TO MARKET A PORTION OF BONDS IN SERIES (B) AND (C) ABOVE.

4. KONCKE COMMENTED ON THE UNCERTAIN SITUATION IN THE FINANCIAL FX MARKET WHICH RATE HAS CONTINUED ITS GRADUAL RISE SINCE THE MARKET WAS LIBERALIZED ON SEPTEMBER 25 AND WHICH WAS AT 2900 PER  
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DOLLAR ON OCTOBER 16, WITH STRONG DEMAND AND VERY LIMITED OFFER. (BANKS ARE CONTINUING TO SELL DOLLARS IN MODEST AMOUNTS TO FAVORED CLIENTS.) KONCKE INDICATED THAT THE FINANCIAL MARKET WAS DEFINITELY NOT CONTROLLED IN ANY WAY BY THE CENTRAL BANK, THAT THE RATE HAD RISEN HIGHER THAN VEGH HAD ORIGINALLY ANTICIPATED AND THE DOLLAR NOW WAS HIGHLY OVERVALUED. (A SMALL PARALLEL MARKET CONTINUES TO FUNCTION.) THE NEW INTEREST RATE STRUCTURE HAS RESULTED IN SIGNIFICANT INCREASES IN BOTH PESO AND DOLLAR

DEPOSITS. HE INDICATED THAT MANY ARGENTINES WERE BRINGING IN ARGENTINE PESOS TO EXCHANGE FOR URUGUAYAN PESOS WHICH IN TURN THEY WERE TRYING TO EXCHANGE FOR DOLLARS. IN ADDITION, THERE ARE WIDESPREAD REPORTS THAT ARGENTINES ARE ACTIVELY BUYING REAL ESTATE OF ALL TYPES AT PUNTA DEL ESTE, PAYING MOSTLY IN DOLLARS, WHICH HAVE NOT FOUND THEIR WAY INTO THE FINANCIAL MARKET.

5. KONCKE ALSO EXPRESSED CONCERN THAT THE WIDE DIFFERENTIAL BETWEEN THE FINANCIAL AND COMMERCIAL RATE (NOW 1390 PER DOLLAR) WOULD LEAD TO FALSE TRADE INVOICING AND RENEWED CATTLE CONTRABAND TO BRAZIL, GIVEN THE CROWDED CATTLE SITUATION ON THE RANGE. THE GOU IS FACED WITH A SERIOUS DILEMMA. IF IT TRIES TO MOVE THE COMMERCIAL RATE MUCH MORE THAN THE CURRENT TREND OF FIVE PERCENT MONTHLY DEVALUATIONS, AN IMMEDIATE INFLATIONARY EFFECT WILL ENSUE, WHICH ON TOP OF THE EXPECTED WAGE AND SALARY INCREASE PROMISED FOR THIS MONTH, WOULD ACTIVELY SPUR INFLATIONARY PRESSURES. ON THE OTHER HAND, IF THE CURRENT SPREAD BETWEEN THE RATES CONTINUES, NON-TRADITIONAL EXPORTS WILL FALTER AND ILLEGAL TRADE PRACTICES WILL FLOURISH.

6. KONCKE CONCLUDES THAT THE ONLY SOLUTION IS FOR THE FINANCIAL MARKET TO STABILIZE AT A LOWER, MORE REALISTIC RATE, AND FOR MINI-DEVALUATIONS OF THE COMMERCIAL MARKET TO CONTINUE AT THE CURRENT PACE. THE KEY TO A SHORT TERM STABILIZATION OF THE FINANCIAL MARKET IS A BREAK IN THE PUBLIC'S EXPECTATIONS OF CONTINUING INCREASES IN THE DOLLAR RATE, WHICH BECOME SELF-FULFILLING PROPHECIES AS SELLERS HOLD OFF THE MARKET AND BUYERS RUSH TO GET DOLLARS BEFORE THE PRICE INCREASES FURTHER. IT WOULD SEEM THAT ONE WAY TO DO THIS NOW IS TO FEED ADDITIONAL DOLLARS INTO THE MARKET, PRESUMABLY FROM THE CENTRAL BANK. HOWEVER, THE CENTRAL BANK MAY BE SHORT ON DOLLARS AND, IN ANY EVENT, SUCH ACTION WOULD CONTRAVENE VEGH'S POLICY OF NOT TRYING TO MANAGE THE FREE FINANCIAL MARKET. OVER THE LONGER TERM, THE WILLINGNESS TO BUY AND HOLD FINANCIAL MARKET PESOS WILL DEPEND ON PUBLIC CONFIDENCE IN THE DURABILITY OF VEGH AND HIS POLICIES. URUGUAYANS HAVE LEARNED FROM

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SAD EXPERIENCE IN THE PAST THAT LIBERALIZATION EFFORTS HAVE OFTEN BEEN

SHORT-LIVED AND IT PAYS TO STAY WITH DOLLARS - THUS THE ECONOMIC CULTURE OF URUGUAY HAS BEEN FOR YEARS TO BUY RATHER THAN SELL DOLLARS. SUCH PUBLIC CONFIDENCE COULD DEVELOP IF VEGH SUCCEEDS IN OBTAINING NEEDED EXTERNAL ASSISTANCE ON REASONABLE TERMS AND CONTINUES TO RECEIVE FIRM POLITICAL/MILITARY SUPPORT OVER THE TIME NECESSARY FOR HIS PROGRAM TO SHOW POSITIVE RESULTS.

7. COMMENT.

THIS IS THE FIRST TIME IN MANY YEARS THAT THE GOU HAS INDICATED A DISPOSITION TO MEET FUNDAMENTAL ECONOMIC REFORM CONDITIONS OF THE IMF AND IBRD. VEGH'S ABILITY TO NEGOTIATE THE PROPOSED AGREEMENTS SUCCESSFULLY AND CARRY OUT IMPLEMENTING ACTIONS WILL DEPEND ON CONTINUED POLITICAL/MILITARY SUPPORT. THERE ARE CONTINUING REPORTS CRITICAL OF VEGH AND HIS PROGRAM IN SOME MILITARY

AND CIVILIAN CIRCLES.

SUBSTANTIAL AMOUNTS OF INTERNATIONAL ASSISTANCE FROM THE IMF-  
IBRD, AS WELL AS THE PROCEEDS FROM DOLLAR BONDS AND LOANS TO THE  
CENTRAL BANK, WILL PRIMARILY BE NEEDED TO COVER BALANCE OF PAYMENTS  
DEFICITS IN 1974 AND 1975. STIMULATING GROWTH IN THE UTUGUAYAN  
ECONOMY WILL, IN THE SHORT RUN, WORSEN THE BALANCE OF PAYMENTS  
PICTURE. FINANCING THE NECESSARILY HIGHER LEVELS OF CAPITAL  
GOODS IMPORTS WILL PRIMARILY DEPEND ON INFLOWS OF PRIVATE AND  
OFFICIAL CAPITAL AND POSSIBLY DRAWING DOWN URUGUAY'S GOLD  
RESERVES AS WELL.  
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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** MEETINGS, MEETING REPORTS, FOREIGN ASSISTANCE AGREEMENTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 21 OCT 1974  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** shawdg  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
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**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** GS  
**Errors:** N/A  
**Film Number:** D740300-0058  
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**Handling Restrictions:** n/a  
**Image Path:**  
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**Legacy Key:** link1974/newtext/t19741031/aaaaazvw.tel  
**Line Count:** 181  
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**Office:** ACTION ARA  
**Original Classification:** CONFIDENTIAL  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 4  
**Previous Channel Indicators:**  
**Previous Classification:** CONFIDENTIAL  
**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** shawdg  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 16 JUL 2002  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <16 JUL 2002 by kelleyw0>; APPROVED <06 MAR 2003 by shawdg>  
**Review Markings:**

Declassified/Released  
US Department of State  
EO Systematic Review  
30 JUN 2005

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** RESULTS OF GOU CONSULTATIONS WITH IMF-IBRD AND OTHER EXTERNAL ASSISTANCE SOURCES  
**TAGS:** ECON, EFIN, UY, IMF, IBRD  
**To:** STATE  
**Type:** TE  
**Markings:** Declassified/Released US Department of State EO Systematic Review 30 JUN 2005